



August 11, 2021

Via Electronic Delivery (to regs.comments@federalreserve.gov)

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: **Docket No. R-1748, RIN 7100-AG15; Debit Card Interchange Fees and Routing**

Dear Ms. Misback:

The Clearing House Association L.L.C. (“The Clearing House”)¹ respectfully submits this comment letter in response to the Board of Governors of the Federal Reserve System’s (the “Board”) notice of proposed rulemaking to amend Regulation II and the Official Board Commentary on Regulation II (the “Commentary”) regarding the prohibition on network exclusivity (the “Proposal”).² The Clearing House appreciates the opportunity to comment on the Proposal.

The substance of this comment letter is divided into two parts. In Part I of this comment letter, The Clearing House provides relevant background on the existing prohibition on network exclusivity, including the Board’s published deliberations in the notice of proposed rulemaking for Regulation II in 2010 (the “2010 Proposed Rule”)³ and in the final rule promulgated by the Board in 2011 (the “2011 Final Rule”).⁴ The juxtaposition between the existing prohibition on network exclusivity in the 2011 Final Rule and the proposed prohibition on network exclusivity in the 2010 Proposed Rule provides important context for The Clearing House’s comments to the Proposal.

In Part II of this comment letter, The Clearing House identifies and discusses aspects of the Proposal that would be ***impracticable, if not impossible***, for issuers to satisfy. Additionally, The Clearing House addresses other aspects of the Proposal that, if adopted in their current form, would create unreasonable interpretive, substantive, or operational challenges for industry participants. Finally, The

¹ The Clearing House is a nonpartisan organization that engages in research, analysis, advocacy, and litigation focused on financial regulation that supports a safe, sound, and competitive banking and payments system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the U.S. See The Clearing House’s web page at www.theclearinghouse.org.

² Debit Card Interchange Fees and Routing, 86 Fed. Reg. 26189 (May 13, 2021).

³ Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81722 (Dec. 28, 2010).

⁴ Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394 (July 20, 2011).

Clearing House recommends specific actions the Board should take to address the concerns raised by The Clearing House in any final rule promulgated by the Board, which are summarized below:

1. The Board should recognize that it would be *impracticable, if not impossible*, for issuers to comply with the proposed requirements that they must enable at least two unaffiliated payment card networks for *every “specific merchant” and “particular type of merchant”* for which their debit cards can be used to process an electronic debit transaction and should *eliminate* the proposed requirements from any final rule ultimately adopted by the Board.
2. The Board should clarify the meaning of “particular type of transaction” by specifying that each electronic debit transaction initiated with a debit card will be characterized as either a card-present transaction or a card-not-present transaction and should establish a definitive test to differentiate between card-present transactions and card-not-present transactions.
3. The Board should (i) clarify the meaning of “geographic area,” (ii) provide that a payment card network can be used by an issuer to satisfy the prohibition on network exclusivity so long as the payment card network is capable of processing electronic debit transactions in every geographic area or is willing to expand its capabilities to do so, and (iii) establish a presumption that a payment card network is willing to expand its capabilities of processing electronic debit transactions to a geographic area if the payment card network does not limit by rule or policy its operation from any geographic area.
4. The Board should clarify that the proposed “means of access” requirements apply to issuers only with respect to issuer-provided or issuer-approved means of access and that “means of access” is not intended to encompass a means or method of authentication or communication.
5. The Board should publish a definitive list of payment card networks that would allow issuers to satisfy the prohibition on network exclusivity by geographic area and transaction type and should establish a grace period for issuers to come into compliance with the prohibition on network exclusivity if a payment card network no longer qualifies for purposes of issuers satisfying the prohibition on network exclusivity.
6. The Board should recognize that, even with the adoption of The Clearing House’s recommendations in this comment letter, issuers would need at least three years to implement the modified Proposal and should establish an effective date for the modified Proposal that is no earlier than three years following its publication in the Federal Register.

The Clearing House is optimistic that the Board will carefully consider the issues identified in this comment letter, will engage in meaningful dialogue with The Clearing House and other industry participants prior to undertaking any further action on the Proposal to better understand and appreciate the operational challenges and undesirable ramifications they pose for the payments industry, and will incorporate The Clearing House's recommendations into any final rule adopted by the Board.

I. Background

a. Summary of the Existing Prohibition on Network Exclusivity

1. *Overview of the Board's considerations in the 2010 Proposed Rule and the 2011 Final Rule regarding the existing prohibition on network exclusivity.*

Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") directed the Board to prescribe regulations to prohibit an issuer or payment card network from "restrict[ing] the number of payment card networks on which an electronic debit transaction may be processed to (i) [one] such network; or (ii) [two] or more such networks which are owned, controlled, or otherwise operated by (I) affiliated persons; or (II) networks affiliated with such issuer."⁵ To implement Section 1075 of the Dodd-Frank Act, the Board promulgated the 2010 Proposed Rule, offering two alternatives, Alternative A and Alternative B, for the implementation of the prohibition on network exclusivity.⁶ Under Alternative A, the Board proposed to prohibit an issuer or payment card network from "restrict[ing] the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks."⁷ Under Alternative B, the Board proposed to prohibit an issuer or payment card network from "restrict[ing] the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks for each method of authorization that may be used by the cardholder."⁸

In discussing Alternative A in the 2010 Proposed Rule, the Board stated that "an issuer and payment card network [would] not violate the [prohibition on network exclusivity under Alternative A] as long as the number of payment card networks on which an electronic debit transaction may be processed is not limited to less than two unaffiliated payment card networks."⁹ The Board recognized "that the effectiveness of [the prohibition on network exclusivity under Alternative A] could be limited in some circumstances if an issuer [could] satisfy the requirement simply by having one payment card network for

⁵ Public Law 111-203, 124 Stat. 2072. Section 1075 of the Dodd-Frank Act (Public Law 111-203, 124 Stat. 2068-2074 (2010)) amends the Electronic Fund Transfer Act (15 U.S.C. 1693 *et seq.*) ("EFTA") to add Section 920 to EFTA.

⁶ *See supra* note 3.

⁷ *Id.* at 81756.

⁸ *Id.*

⁹ *Id.* at 81749.

signature debit transactions and a second unaffiliated payment card network for PIN debit transactions.”¹⁰ However, the Board made clear that “[n]othing in [the Dodd-Frank Act] specifically requires that there must be two unaffiliated payment card networks available to the merchant once the method of debit card authorization has been determined”¹¹ and that “the statute does not expressly require issuers to offer multiple unaffiliated signature and multiple unaffiliated PIN debit card network choices on each card.”¹²

In discussing Alternative A in the 2011 Final Rule, the Board expressly acknowledged Alternative A would provide merchants with fewer routing options for certain electronic debit transactions.¹³ The Board nevertheless adopted Alternative A, emphasizing that “Alternative A is most consistent with EFTA Section 920(b)(1)(A)”¹⁴ and that “[t]he plain language of the statute does not require that there be two unaffiliated payment card networks available to the merchant for each method of authentication.”¹⁵

2. Overview of the language in Regulation II related to the existing prohibition on network exclusivity.

Section 235.7(a) of Regulation II and the Commentary sets forth the existing prohibition on network exclusivity. Section 235.7(a)(1) provides that “[a]n issuer or payment card network shall not . . . restrict the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks.”¹⁶ Section 235.7(a)(2) specifies that “[a]n issuer satisfies the requirements of [the prohibition on network exclusivity] only if the issuer allows an electronic debit transaction to be processed on at least two unaffiliated payment card networks, each of which does not, by rule or policy, restrict the operation of the network to a limited geographic area, specific merchant, or particular type of merchant, and each of which has taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably expect will be routed to it, based on expected transaction volume.”¹⁷

In clarifying the scope and application of Section 235.7(a)(1), the Board reiterates, in Comment 7(a)-1 of the Commentary, that while the prohibition on network exclusivity requires debit cards to be enabled on at least two unaffiliated payment card networks, it does not require two or more unaffiliated networks to be available for each method of cardholder authentication.¹⁸ In the same comment, the Board deems it sufficient, for purposes of complying with the prohibition on network exclusivity, for an issuer to

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ 76 Fed. Reg. 43394, 43448.

¹⁴ *Id.* at 43447.

¹⁵ *Id.*

¹⁶ 12 C.F.R. § 235.7(a)(1).

¹⁷ 12 C.F.R. § 235.7(a)(2).

¹⁸ 12 C.F.R. Part 235, App. A, at 7(a)-1.

issue debit cards that operate on one signature-based payment card network and one unaffiliated PIN-based payment card network, on two or more unaffiliated signature-based payment card networks, or on two or more unaffiliated PIN-based payment card networks.¹⁹ In Comment 7(a)-2 of the Commentary, the Board clarifies that it is permissible for issuers to use “[a] smaller payment card network . . . to help satisfy the [prohibition on network exclusivity] if the network [is] willing to expand its coverage in response to increased merchant demand for access to its network and it meets the other requirements for a permitted arrangement, including taking steps reasonably designed to enable it to process the electronic debit transactions that it would reasonably expect to be routed to it.”²⁰ The Board notes, however, that a smaller payment card network could not be used to help satisfy the prohibition on network exclusivity if “the network’s policy or practice is to limit such expansion.”²¹ Finally, the Board specifies, in Comment 7(a)-7 of the Commentary, that the prohibition on network exclusivity “require[s] that all debit cards be enabled on at least two unaffiliated payment card networks for electronic debit transactions, regardless of whether the debit card is issued in card form,”²² and that “[t]his applies to any supplemental device, such as a fob or token, or chip or application in a mobile phone, that is issued in connection with a plastic card, even if that plastic card fully complies with the rule.”²³

In separate publications, the Board has reiterated that an issuer complies with the prohibition on network exclusivity if the issuer enables at least two unaffiliated payment card networks on each debit card issued by the issuer, has emphasized that an issuer may enable “any two networks so long as the networks are unaffiliated and have reasonable capacity,” and has restated the examples of permissible enablement configurations set forth in the Commentary for satisfying the prohibition on network exclusivity.²⁴

b. Summary of the Proposal

Under the Proposal, Section 235.7(a)(2) of Regulation II would be amended to provide that an issuer satisfies the requirements of the prohibition on network exclusivity “only if, for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction, such issuer enables at least two unaffiliated payment card networks to process an electronic debit transaction, and where each of these

¹⁹ *Id.*

²⁰ *Id.* at 7(a)-2.

²¹ *Id.*

²² *Id.* at 7(a)-7.

²³ *Id.*

²⁴ Board of Governors of the Federal Reserve System, Debit Card Interchange Fees and Routing – A Small Entity Compliance Guide (available at, <https://www.federalreserve.gov/supervisionreg/regiicg.htm>).

networks has taken steps reasonably designed to be able to process the electronic debit transactions that it would reasonably expect will be routed to it, based on expected transaction volume.”²⁵

The Proposal also would amend the Commentary related to the existing prohibition on network exclusivity. The Board would reiterate, in Comment 7(a)-1, the new requirement in the Proposal that the prohibition on network exclusivity “requires an issuer to configure each of its debit cards so that each electronic debit transaction initiated with such card can be processed on at least two unaffiliated payment card networks . . . for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer’s debit card can be used to process an electronic debit transaction.”²⁶ The Board also would specify in Comment 7(a)-1 that, as long as an issuer configures its debit cards such that each electronic debit transaction initiated with such cards can be processed on at least two unaffiliated payment card networks for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which such cards can be used to process an electronic debit transaction, the prohibition on network exclusivity “does not require [an issuer to configure its debit cards in this manner] for each method of cardholder authentication (*e.g.*, signature, PIN, biometrics, any other method of cardholder authentication that may be developed in the future, or the lack of a method of cardholder authentication).”²⁷ Finally, the Board would indicate in Comment 7(a)-1 that “it is sufficient for an issuer to issue a debit card that can process signature-authenticated transactions only over one payment card network and PIN-authenticated transactions only over another payment card network, as long as the two payment card networks are not affiliated and each network can be used to process electronic debit transactions for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer’s debit card can be used to process an electronic debit transaction.”²⁸

In Comment 7(a)-2.i., the Board would clarify that “[a] payment card network could be used to satisfy the requirement that an issuer enable two unaffiliated payment card networks for each electronic debit transaction if the network was either (a) capable of processing the volume of electronic debit transactions that it would reasonably expect to be routed to it or (b) willing to expand its capabilities to meet such expected transaction volume.”²⁹ The Board also would make clear in Comment 7(a)-2.i. that a payment card network would not qualify as a payment card network for purposes of satisfying the prohibition on network exclusivity “[i]f . . . the network’s policy or practice is to limit such expansion . . .”³⁰

²⁵ 86 Fed. Reg. 26189, 26194.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

The Board would provide, at least by implication and example, more color in Comment 7(a)-2.iii regarding its expectations for the geographic area, specific merchant, particular type of merchant, and particular type of transaction requirements. Specifically, the Board would state that an issuer must enable at least two unaffiliated payment card networks “[f]or every geographic area (*e.g.*, New York), specific merchant (*e.g.*, a specific fast food restaurant chain), particular type of merchant (*e.g.*, fast food restaurants), and particular type of transaction (*e.g.*, card-not-present transaction) for which the issuer’s debit card can be used to process an electronic debit transaction”³¹ The Board also would set forth examples of how an issuer could comply with the requirement to enable at least two unaffiliated payment card networks for every geographic area and for every particular type of transaction.³²

Finally, the Board would provide, in Comment 7(a)-7, that the prohibition on network exclusivity requires “a debit card be enabled by the issuer on at least two unaffiliated payment card networks for each means of access,” and that “[t]he means of access that carries the debit card information could be a plastic card, a supplemental device such as a fob, information stored inside an e-wallet on a mobile phone or other device, or another means of access that may be developed in the future.”³³

II. The Clearing House’s Comments

- a. The Board should recognize that it would be *impracticable, if not impossible*, for issuers to comply with the proposed requirements that they must enable at least two unaffiliated payment card networks for *every “specific merchant” and “particular type of merchant”* for which their debit cards can be used to process an electronic debit transaction and should *eliminate* the proposed requirements from any final rule ultimately adopted by the Board.³⁴

Based on the plain meaning of the proposed requirements that an issuer satisfies the prohibition on network exclusivity only if it enables at least two unaffiliated payment card networks for “*every specific merchant” and “particular type of merchant,”* it would be impracticable, if not impossible, for an issuer to enable at least two unaffiliated payment card networks to process an electronic debit transaction for every specific merchant and particular type of merchant for which the issuer’s debit card can be used to process an electronic debit transaction. Indeed, the proposed requirements appear to be based on the flawed premise that issuers know, have visibility into, or are otherwise able to determine or control the

³¹ 86 Fed. Reg. 26189, 26194.

³² *Id.*

³³ *Id.* at 26195.

³⁴ *Id.* at 26194. While the Board does not define “particular type of merchant,” the Commentary proposed by the Board suggests that it is intended to refer to categories of merchants (*e.g.*, fast food restaurants). *Id.* The Board did not, however, address key considerations in the Proposal, such as how merchant categories would be determined (*e.g.*, by the Board or based on payment card network merchant category codes) or the level of specificity the Board or payment card networks would employ to define and segment merchant categories (*e.g.*, casual dining versus fast food restaurants).

merchant acceptance decisions of every individual merchant and every category of merchant now or hereafter in existence.

1. *Merchants and/or their third-party service providers generally determine and control which payment card networks' debit cards a merchant will accept.*

In general, merchants or their third-party service providers have and maintain control over their payment card acceptance decisions, including the extent to which they are willing to accept debit cards enabled for transactions on a particular payment card network. A merchant may instruct its acquirer or other third-party service provider, at the outset of a contractual relationship or during the course of the relationship, to enable or disable that merchant's acceptance of a particular payment card network's debit cards. To further complicate matters, many specific merchants and particular types of merchants (*e.g.*, restaurants, barber shops, and health care providers) engage third-party service providers, such as independent software vendors, independent sales organizations, merchant servicers, and payment facilitators, that, either alone or in conjunction with other third parties, act as intermediaries between merchants and payment card networks and offer bundled products and services to merchants through which payment card acceptance decisions may be delegated to, or automated by, these third-party service providers. The proposed requirements would subject issuers to the whims of merchants and/or their third-party service providers with respect to their payment card acceptance decisions, empowering merchants and/or their third-party service providers to render a payment card network as insufficient for purposes of satisfying the proposed "specific merchant" and "particular type of merchant" requirements of the prohibition on network exclusivity at any point in time. An issuer that has enabled two payment card networks on its debit cards and satisfies the prohibition on network exclusivity today may find itself out of compliance tomorrow if a particular merchant or its third-party service provider elects to discontinue acceptance of debit cards issued on one of the payment card networks enabled on the issuer's debit cards.

2. *Payment card networks manage risk by restricting participation of certain individual merchants and certain types of merchants and issuers manage risk by joining payment card networks that control for unacceptable merchant risk.*

The proposed requirements would prevent operators of payment card networks from managing the risks associated with the administration and operation of their networks, and would interfere with issuers' management of risks of participation in networks. Operators of payment card networks, as third parties in services relationships with regulated financial institutions and as entities directly subject to regulatory requirements (such as the Bank Secrecy Act), satisfy their risk management obligations, in part, by limiting network access by specific merchants and particular types of merchants that pose unacceptable risks to the payment card network itself or to the payment card network's financial institution participants. For example, a payment card network may restrict or otherwise prohibit individual merchants or certain types of merchants that present unacceptable legal risk (such as

merchants operating in the cannabis or online gaming industries), financial risk (such as merchants that have unsound financial practices or that have a history of engaging in high-risk or fraudulent activities and are included on the Member Alert to Control High-Risk Merchants list (the “MATCH List”)³⁵ or other terminated merchant file), or reputational risk (such as merchants providing certain types of questionable adult entertainment or merchants that otherwise do not adhere to brand standards). Acquirers may need to restrict or otherwise prohibit individual merchants or certain types of merchants for the same reasons. As a matter of legal, financial, and reputational risk, financial institution participants in payment card networks generally rely on operators of such payment card networks to identify and mitigate the risks associated with their payment card networks, and financial institutions participate in payment card networks whose risk management policies are acceptable to such financial institutions. The Proposal would prevent or limit these critical risk management functions of payment card networks and issuers by creating risk that a payment card network’s exclusion of a specific merchant or particular types of merchants would render that payment card network ineligible for satisfying the prohibition on network exclusivity.

3. Merchants may limit the payment card networks they accept through the transaction authentication methods they support.

As noted in Part I.a. of this comment letter, in the 2011 Final Rule, the Board articulated the fundamental principle, based on the language of Section 1075 of the Dodd-Frank Act, that an issuer is *not* required to offer multiple unaffiliated payment card networks for each method of cardholder authentication.³⁶ In keeping with the Board’s conclusion in the 2011 Final Rule that this interpretation is most consistent with the language of the statute, the Board reiterated this principle in the Commentary.³⁷ Despite this well-settled principle, the proposed “specific merchant” and “particular type of merchant” requirements and associated Commentary suggest that issuers may be expected to enable two unaffiliated payment card networks for each method of cardholder authentication supported by a specific merchant or a particular type of merchant, since some specific merchants and particular types of merchants may only support certain types of cardholder authentication methods. For example, a single-message payment card network that requires PIN authentication at the point of sale for card-present transactions will not be capable of acceptance at merchants that elect not to deploy PIN pads or elect not to support PIN as a method of transaction authentication. The decision by a payment card network to require a more secure authentication method for card-present transactions, coupled with merchants’ decisions not to support PIN authentication for card-present transactions, will mean that debit cards issued on the payment card network will not be accepted at every “specific merchant” and that there

³⁵ The MATCH List is used within the payment card industry to identify merchants that have engaged in unacceptable merchant behavior.

³⁶ 76 Fed. Reg. 43394, 43447; *see also* 12 C.F.R. Part 235, App. A, at 7(a)-1 (The existing Commentary clarifies that Section 235.7(a) does not “require an issuer to have two or more unaffiliated networks available for each method of cardholder authentication.”).

³⁷ 86 Fed. Reg. 26189, 26192.

likely will be “particular types of merchants” where PIN acceptance is less common (*e.g.*, hotels, airlines, and car rental companies) and debit cards issued on the payment card network will not be accepted. Issuers should not be left to wonder whether their chosen payment card networks satisfy the prohibition on network exclusivity.

The Clearing House acknowledges that the plain-meaning interpretation of the proposed “specific merchant” and “particular type of merchant” requirements may not reflect the Board’s actual intent with respect to the Proposal. The Clearing House believes that the Board may be attempting to disallow the use of a payment card network to satisfy the prohibition on network exclusivity if the payment card network is accepted only at certain specific merchants or certain types of merchants. The Clearing House notes, however, that if the Board is attempting to prevent the use of limited acceptance payment card networks for purposes of satisfying the prohibition on network exclusivity, it would not be necessary for the Board to amend Regulation II and the Commentary since this concept already exists in Comment 7(a)-2, which currently provides that “[a] payment card network that is accepted only at a limited category of merchants (such as a particular grocery store chain, merchants located in a particular shopping mall, or a single class of merchants, such as grocery stores or gas stations) would not satisfy the rule.”³⁸ If the Board intends the Proposal to expand the specific merchant or type of merchant acceptance obligations of a payment card network beyond what exists in Comment 7(a)-2 of Regulation II today, the expanded requirements will have impractical and undesirable effects on issuers’ and payment card networks’ ability to comply with the prohibition on network exclusivity while appropriately managing risks and satisfying other principles of Regulation II.

³⁸ 12 C.F.R. Part 235, App. A, at 7(a)-2.ii.

- b. The Board should clarify the meaning of “particular type of transaction” by specifying that each electronic debit transaction initiated with a debit card will be characterized as either a card-present transaction or a card-not-present transaction and should establish a definitive test to differentiate between card-present transactions and card-not-present transactions.

The Commentary proposed by the Board suggests that the Board categorizes transactions as either “card-present transactions” or “card-not-present transactions.”³⁹ The Clearing House believes that this is the appropriate characterization of all transactions and encourages the Board to adopt this approach without any further gradation of transaction types within the card-present transaction and card-not-present transaction categories. Indeed, any further narrowing of transaction types within the card-present transaction and card-not-present transaction categories would codify existing technologies and marketplace practices, thereby inhibiting innovation, and would be tantamount to requiring issuers to enable two unaffiliated payment card networks for each method of authentication. As the Board expressly acknowledged in the 2010 Proposed Rule and in the 2011 Final Rule, Section 1075 of the Dodd-Frank Act does not require issuers to enable at least two unaffiliated payment card networks for each method of cardholder authentication.⁴⁰ Additionally, defining “particular type of transaction” to include subcategories of card-present and card-not-present transactions would inhibit innovation by preventing issuers from supporting new transaction types or cardholder authentication methods for one payment card network enabled on their debit cards unless at least two unaffiliated payment card networks enabled on their debit cards also support the same transaction type or cardholder authentication method. For example, if an issuer has enabled its debit cards in Payment Card Network A and Payment Card Network B, each of which supports card-present transaction types through inserting the debit card into a point-of-sale device, the issuer’s compliance with the prohibition on network exclusivity should not be threatened if the issuer supports a new technology implemented by Payment Card Network A supporting contactless initiation of card-present transactions even if Payment Card Network B does not support contactless transactions.

As the Board knows, certain types of transaction initiation or authentication are riskier (for fraud or data security reasons) than other types of transaction initiation. Continuing the example above, if Payment Card Network A and Payment Card Network B both enable support for contactless initiation of card-present transactions, but Payment Card Network B’s contactless transaction initiation solution creates greater risk for the issuer or its cardholders (either due to technology used or payment card network rule standards) than the contactless transaction initiation solution deployed by Payment Card

³⁹ 86 Fed. Reg. 26189, 26194.

⁴⁰ 76 Fed. Reg. 43394, 43447 (In the 2011 Final Rule, the Board adopted Alternative A and expressed its view that Alternative A was the “most consistent with EFTA Section 920(b)(1)(A),” emphasizing that “the statute [did] not expressly require issuers to offer multiple unaffiliated signature and multiple unaffiliated PIN debit card network choices on each card.”); 86 Fed. Reg. 26189, 26192; *see also* 12 C.F.R. Part 235, App. A, at 7(a)-1 (The existing Commentary clarifies that Section 235.7(a) does not “require an issuer to have two or more unaffiliated networks available for each method of cardholder authentication.”).

Network A, the issuer should be allowed to enable support for contactless transaction initiation through Payment Card Network A without also having to enable support for contactless transaction initiation through Payment Card Network B in order to comply with the prohibition on network exclusivity, so long as the issuer enables a method of card-present and card-not-present transaction initiation on both payment card networks. The same principles apply equally to card-not-present transaction initiation and authentication methods.⁴¹ Thus, the Board must preserve the rights of issuers to protect themselves and their cardholders against fraud by determining the types of card-present and card-not-present transactions they enable on, and the cardholder authentication methods they support for, their debit cards, so long as their debit cards are enabled on two unaffiliated payment card networks for card-present and for card-not-present transactions.

Finally, the Board should establish a definitive test to differentiate between card-present transactions and card-not-present transactions. The Clearing House recommends that the definitive test should be based on whether the means of access physically interacts with a merchant's point-of-sale terminal to initiate a transaction. Any transaction where the means of access physically interacts (including through contactless, proximity-based data transfer) with the merchant's point-of-sale equipment should be characterized as a card-present transaction. Any transaction where the means of access does not physically interact with the merchant's point-of-sale equipment should be characterized as a card-not-present transaction. Through this distinction, issuers will be better equipped to ensure that they enable at least two unaffiliated payment card networks on their debit cards for each particular type of transaction.

- c. The Board should (i) clarify the meaning of "geographic area," (ii) provide that a payment card network can be used by an issuer to satisfy the prohibition on network exclusivity so long as the payment card network is capable of processing electronic debit transactions in every geographic area or is willing to expand its capabilities to do so, and (iii) establish a presumption that a payment card network is willing to expand its capabilities of processing electronic debit transactions to a geographic area if the payment card network does not limit by rule or policy its operation from any geographic area.

The Commentary proposed by the Board suggests that the Board intends for "geographic area" to mean each of the 50 U.S. states.⁴² In general, The Clearing House agrees with this definition. However, The Clearing House does have concerns with the potential consequences associated with the application of the "geographic area" requirement in the Proposal to the extent the requirement can be read to mean

⁴¹ See Federal Reserve System, Interchange Fee Revenue, Covered Issuer Cost, and Covered Issuer and Merchant Fraud Loss Related to Debit Card Transactions (2019) (Figure 14 of the report illustrates the composition of fraud losses in 2019 expressed as a share of transaction value into four types of fraud: (1) lost and stolen fraud, (2) counterfeit fraud, (3) card-not-present fraud, and (4) other fraud. Card-not-present fraud accounted for more than half of overall fraud in 2019.).

⁴² 86 Fed. Reg. 26189, 26194.

a payment card network must have actual acceptance at merchants located in each of the 50 U.S. states. First, the proposed requirement suggests that issuers know, have visibility into, or are otherwise able to determine the geographic locations of merchants, which is difficult in an increasingly internet-based economy. Second, the proposed requirement could be read as subjecting issuers to the whims of merchants and payment card networks, presenting the same unreasonable challenges for issuers as noted above with respect to the “specific merchant” and “particular type of merchant” requirements. Finally, the proposed requirement may prevent issuers from using a number of single-message payment card networks that currently satisfy the standard under the existing prohibition on network exclusivity because they are willing to be accepted in every U.S. state, even if they have not yet reached (or have fallen out of meeting) the standard.

To avoid an unintended, substantial impact on industry participants, the Board should provide that a payment card network can be used by an issuer to satisfy the “geographic area” requirement so long as the payment card network is capable of processing electronic debit transactions in every geographic area (*i.e.*, in every U.S. state) or is willing to expand its capabilities for processing electronic debit transactions to every geographic area where there is merchant demand for acceptance of the payment card network. For purposes of determining whether a payment card network is willing to expand its capabilities for processing electronic debit transactions to every geographic area where there is merchant demand for acceptance of the payment card network, the Board should establish a presumption that a payment card network may be used to satisfy the proposed requirement so long as the payment card network does not, by rule or policy, limit its expansion to specific geographic areas. This presumption would be consistent with, and should be construed as a clarification of, the requirements of the geographic area requirement under existing Section 235.7(a)(2) of Regulation II, which provides that an issuer satisfies the prohibition on network exclusivity “only if the issuer allows an electronic debit transaction to be processed on at least two unaffiliated payment card networks, each of which does not, by rule or policy, restrict the operation of the network to a limited geographic area”⁴³ As the Board noted when it adopted existing Section 235.7(a)(2) of Regulation II, an issuer’s enablement of a payment card network operating on a nationwide basis should not be “the sole means by which an issuer could satisfy the [prohibition on network exclusivity]”⁴⁴ since such an “overly restrictive nationwide coverage requirement may reduce network choice for issuers, with little benefit to merchants”⁴⁵

⁴³ 12 C.F.R. § 235.7(a)(2).

⁴⁴ 76 Fed. Reg. 43394, 43449.

⁴⁵ *Id.*

- d. The Board should clarify that the proposed “means of access” requirements apply to issuers only with respect to issuer-provided or issuer-approved means of access and that “means of access” is not intended to encompass a means or method of transaction authentication or communication.

In setting forth the expectation that debit cards must be enabled by an issuer on at least two unaffiliated payment card networks for each “means of access,” the Board presupposes that issuers will always know, have visibility into, or be able to determine any means of access being used by their cardholders at any time. Even if issuers could identify each means of access used by their cardholders, issuers would be limited in their ability to exercise control over every third-party provider of a means of access to ensure, for instance, that such means of access has the technical capabilities to enable issuers to satisfy the means of access requirements of the prohibition on network exclusivity (unless the Board expects issuers to broadly restrict consumer choice in their cardholder agreements by prohibiting cardholders from using any means of access that is not provided or approved by issuers). Therefore, the Board should clarify, in Comment 7(a)-7 of the Commentary, that the means of access requirements apply to issuers only with respect to issuer-provided or issuer-approved means of access and that issuer-approved means of access consist of means of access made available by third parties pursuant to a direct agreement with issuers.

The Board also should clarify in Comment 7(a)-7 of the Commentary that a “means of access” is limited to the means by which a debit card or debit card credentials (*e.g.*, the card number) are stored and does not encompass a means or method of transaction authentication or communication of debit card credentials. Given the potential commonalities of, and overlap between, a means of access and a means or method of communication (*e.g.*, a two-dimensional barcode is a method of communication but may be presented by mobile device, which could be a means of access when it stores payment credentials), The Clearing House is concerned that the proposed requirement could have overbroad, unintended consequences, and the absence of any discussion by the Board regarding this proposed requirement leaves industry participants with little information and guidance as to how the Board expects industry participants to distinguish between a means of access and a means or method of transaction authentication or communication. Without clearly delineating between a means of access as a means of storing a debit card or debit card credentials and a means or method of transaction authentication or communication, the proposed requirement could result in an outcome where issuers would be required to enable two unaffiliated payment card networks for each means or method of authentication or communication, which, as the Board acknowledged in the 2010 Proposed Rule and in the 2011 Final Rule, would be inconsistent with Section 1075 of the Dodd-Frank Act.⁴⁶

⁴⁶ See *supra* note 40.

- e. The Board should publish a definitive list of payment card networks that would allow issuers to satisfy the prohibition on network exclusivity by geographic area and transaction type and should establish a grace period for issuers to come into compliance with the prohibition on network exclusivity if a payment card network no longer qualifies for purposes of issuers satisfying the prohibition on network exclusivity.

Given the complexities of the Proposal, the inability of issuers to know or otherwise determine or obtain information that is necessary to comply with the Proposal, and the consequences of non-compliance with Regulation II, the Board must play a meaningful role in developing and making available definitive resources that can be used by issuers to facilitate compliance with any final rule ultimately adopted by the Board. Accordingly, the Board should publish, on an annual basis, a definitive list of payment card networks that would allow issuers to satisfy the prohibition on network exclusivity, including by geographic area and transaction type (as those proposed requirements are modified consistent with The Clearing House's recommendations in this comment letter).⁴⁷ Further, the Board should specify, in Regulation II, the Commentary, or in the frequently asked questions regarding Regulation II and the Commentary, that issuers may rely on the definitive list of payment card networks published by the Board for purposes of complying with the prohibition on network exclusivity.

Finally, the Board should establish a grace period for issuers to come into compliance with the prohibition on network exclusivity if a payment card network no longer qualifies for purposes of issuers satisfying the prohibition on network exclusivity, which grace period should begin as of the date the payment card network is removed from the definitive list published by the Board and should be of sufficient duration to allow issuers to transition to a qualifying payment card network. In determining the duration of any grace period, the Board should take into account the considerations discussed in Part II.f. below regarding the establishment of new arrangements with payment card networks and the substantial technological and operational efforts involved in implementing changes to comply with the Proposal (as modified consistent with The Clearing House's recommendations in this comment letter).

⁴⁷ This list would operate similarly to the list published by the Board of issuers who qualify for the small issuer exemption and those who do not based on asset size. See Federal Reserve System, Interchange Fee Standards: Small Issuer Exemption (June 9, 2021) (available at: <https://www.federalreserve.gov/paymentsystems/regii-interchange-fee-standards.htm>).

- f. The Board should recognize that, even with the adoption of The Clearing House's recommendations in this comment letter, issuers would need at least three years to implement the modified Proposal and should establish an effective date for the modified Proposal that is no earlier than three years following its publication in the Federal Register.

The Clearing House believes that the Board may not be adequately considering the operational feasibility and practical ramifications of the Proposal. Even with the modifications to the Proposal recommended by The Clearing House, industry participants would be required to invest substantial time and resources into the implementation of the modified Proposal. Below is a non-exhaustive list of examples:

1. Issuers must evaluate their existing single-message payment card networks to determine whether they offer a card-not-present transaction solution that enables compliance with the modified Proposal. If an issuer's existing single-message payment card network offers a compliant card-not-present transaction solution, then the issuer must validate that the card-not-present transaction solution satisfies the safety, soundness, security, and other regulatory requirements and expectations of the issuer. If the card-not-present transaction solution satisfies the issuer's requirements and expectations, then the issuer must amend its agreement with the single-message payment card network to account for the issuer's access to and use of the card-not-present transaction solution (assuming the issuer is not already using the card-not-present solution) and must undertake and complete all technical planning, implementation work, and testing before going live with the card-not-present transaction solution.
2. If an issuer's existing single-message payment card network does not offer a card-not-present transaction solution that enables compliance with the modified Proposal and otherwise meets the issuer's requirements and expectations, then the issuer must establish a relationship with a new single-message payment card network. In this case, the issuer must: (i) unwind its existing single-message payment card network relationship; (ii) identify potential replacement single-message payment card networks; (iii) undertake and complete a full evaluation of one or more potential replacement single-message payment card network(s), including the operational, compliance, risk, and other capabilities and controls of such single-message payment card network(s), consistent with the third-party risk-management expectations of the federal banking agencies and the issuer's own internal requirements and expectations; (iv) negotiate and execute a suitable agreement with one or more replacement single-message payment card network(s); and (v) undertake and complete

all technical planning, implementation work, and testing before going live with one or more replacement single-message payment card network(s).

3. For single-message payment card networks that do not broadly support card-not-present transaction solutions and related capabilities in all e-commerce channels, issuers would not be able to complete their technical planning, implementation work, and testing until such single-message payment card networks enhance their existing solutions and capabilities or develop new solutions and capabilities in a manner that enables compliance with the modified Proposal and otherwise meets issuers' needs and expectations. Moreover, if single-message payment card networks require issuers to adopt specific card-not-present transaction capabilities in e-commerce channels, issuers must have sufficient time to undertake and complete any necessary development and implementation work and testing to support the new requirements.
4. Since e-commerce channels have the highest concentration of fraud, issuers would need to enable claims automation capabilities for card-not-present transactions in e-commerce channels. Some issuers currently may rely on the claims-automation capabilities offered by major payment card networks to accelerate the speed at which they can research and resolve claims for cardholders and to improve the overall accuracy of processed claims. The claims-automation capabilities offered by major payment card networks may be more robust than other payment card networks, which means issuers would need time to enhance their authorization and disputes-handling processes and procedures if they have enabled one of these other payment card networks on their debit cards. While issuers may be able to work around the limited capabilities of certain payment card networks through the implementation of manual processes, these processes would negatively impact customer service, including by causing delays in the resolution of Regulation E claims and creating Regulation E compliance risk for issuers.

Given the technical and operational requirements and practical ramifications of instituting the systems, technological capabilities, and training to support compliance with the modified Proposal, the Board should establish an effective date that provides sufficient time for issuers and payment card networks to implement and operationalize the modified Proposal, which date should be no earlier than three years following the publication of such modified Proposal in the Federal Register.

* * * * *

In closing, The Clearing House encourages the Board to continue to proceed cautiously in its consideration of any further re-opening of Regulation II related to interchange transaction fees. As the Board highlighted in the 2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and

Merchant Fraud Losses Related to Debit Card Transactions, the cap on interchange transaction fees covered the authorization, clearing, and settlement costs and fraud losses for 78.6 percent of covered issuers in 2019 (the “2019 Debit Card Transactions Report”).⁴⁸ While this represents a slight increase over 2017 numbers, it remains below the threshold established and used by the Board in promulgating Regulation II such that covered issuers at the 80th percentile would be able to recover their allowable costs. As the Board continues to examine the data in the 2019 Debit Card Transactions Report, The Clearing House encourages the Board to engage in robust discussion with The Clearing House and other industry participants regarding its interpretation of the data before undertaking any further administrative action with respect to Regulation II.

Thank you for your consideration and review of these comments. If you have any questions or wish to discuss this letter, please do not hesitate to contact me using the contact information provided below.

Yours very truly,

/s/

Robert C. Hunter
Executive Managing Director & Deputy General
Counsel
(336) 769-5314
Rob.Hunter@TheClearingHouse.org

⁴⁸ Federal Reserve System, Interchange Fee Revenue, Covered Issuer Cost, and Covered Issuer and Merchant Fraud Loss Related to Debit Card Transactions (2019).